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REPORT

OF

THE SUBCOMMITTEE ON CORPORATION

TAXATION

TO

THE MARYLAND TAX REVISION

COMMISSION OF 1939

October 7, 1940

Francis J. Carey, Chairman

Huntington Cairns

Oscar Leser

H. H. Walker Lewis

The recommendations in this report have been tentatively approved by the Commission. Comments and criticisms are requested.

TO THE MARYLAND TAX REVISION COMMISSION OF 1939:

The Subcommittee on Corporation Taxation submits herewith for consideration by the Commission a memorandum of its recommendations.

As the Commission knows the tax laws of this State have been characterized by discriminations against domestic corporations and discriminations against intrastate commerce. The discriminations against domestic corporations arose largely from the employment for one reason or another of different methods of taxing domestic and foreign corporations. The last session of the Legislature removed some of these discriminations. The subcommittee is recommending removal of others. The discriminations against intrastate commerce arose through the imposition of taxes which under the Constitution of the United States cannot be applied equally to interstate and foreign commerce. These can only be removed by selecting taxes which can be applied equally. The subcommittee is recommending the selection of such taxes. Illustrations of both kinds of discriminations will be given.

The property tax furnishes an example of the discriminations against domestic corporations. The subcommittee's studies indicate that assessments of property of foreign utilities are less than 40% of those of domestic utilities for each dollar of their net operating income allocable to Maryland. This means that customers of domestic utilities bear a very much greater relative share of the property tax burden than customers of foreign utilities. The principal reason for the difference is that domestic utilities are centrally assessed while foreign utilities are locally assessed. (We are dealing here with weighted averages. There are individual foreign utilities which are overassessed and individual domestic utilities which are underassessed.) The subcommittee is recommending central assessment for all utilities and also for railroads,

An example of the discriminations against intrastate commerce is found in the gross receipts tax. The tax is in conflict with the commerce clause of the United States Constitution in many of its applications. The result is that the law imposing it cannot be enforced as written. One illustration will suffice. The communication companies pay this tax on their intrastate receipts, but not on their interstate or foreign receipts although in terms it applies to all receipts. The burden of the tax, which is at the rate of 2% of gross receipts, thus falls entirely on intrastate users. The subcommittee is recommending the selection of a tax which can constitutionally be applied equally so that interstate and foreign commerce will bear its fair share of the tax burden.

The subcommittee is recommending other changes designed to remove inequalities as well as changes looking to greater efficiency in administering corporation taxes.

The work of the subcommittee has been materially hampered by the paucity of tax statistics in this State. This is undoubtedly true also of the work of other subcommittees. It is believed, however, that the administrative reorganization recommended by the Commission will lead to the compilation of adequate statistics in the future.

Francis J. Carey, Chairman

Huntington Cairns

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H. H. Walker Lewis

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DEFINITIONS

As used herein:

"Utility" means a public service corporation other than a railroad.

"Railroad" means a railroad "worked by steam". Section 2 (19) provides that "railroads worked by steam shall include any railroad operated by steam on the 30th day of March, 1906".

"Net operating income" means "net operating income" as reported, with rent accounts eliminated.

"City" includes an incorporated city, town or village; and, where special rates apply therein, includes an assessment district or part of a county or city. (Sec. 2(11).)

"1928 Report" means the Final Report dated December 1, 1928, of the Maryland Tax Revision Commission appointed under Chapter 687 of the Laws of 1927.

Unless otherwise indicated, references are to sections of Article 81 of the Annotated Code (Edition of 1924) as amended.

ANNUAL REPORTS

Section 178 requires all domestic corporations to report to the State Tax Commission, except the following:

Building or homestead associations.
Credit unions.
Corporations having no capital stock.
Charitable, benevolent and fraternal institutions.

Credit unions report to the Bank Commissioner; insurance companies having no capital stock and fraternal beneficiary associations report to the Insurance Commissioner; the others report to no one. Many of such corporations have long since ceased to function but the Commission has no record, and no practicable way of obtaining a record, of their status.

Section 178 should be amended so as to require all domestic corporations, and all foreign corporations subject to the jurisdiction of this State, to make annual reports of some kind to the central assessing authority. The reports would, among other things, serve to keep a central agency advised as to the status of the corporation, the location of its office and the names and addresses of its officers and directors.

Section 179 imposes money penalties for failure to file reports required by Section 178. Section 180 provides that any foreign corporation that fails to file with the Commission any report required by law shall forfeit all right to do intrastate business. Section 144 should be amended so as to provide for forfeiture of charters of domestic corporations, which fail, after a decent opportunity, to file such reports. A corresponding amendment should be made to Section 144-1/2 relating to revival. At present Section 144 provides for forfeiture of charters of domestic corporations for failure to pay to this State, or the proper officers thereof, franchise, share and gross receipts taxes, with interest and penalties due thereon. Section 144 should also be changed to embrace all State taxes other than those on real estate.

BONUS TAX

Domestic corporations having capital stock, except railroad corporations authorized to construct, maintain or operate railroads in this State, and except building or homestead associations, cooperative

associations and credit unions, pay a bonus tax determined by the amount of authorized capital stock. (Sections 133, 134, and, as to credit unions, 14 Op. A. G. 76.) Shares without par value are treated as if they were of the par value of $100 each.

It is recommended that authorized capital stock be continued as the measure of the tax, but that shares without par value be treated as if they were of the par value of $20 each. When the present provision was enacted in 1916, $100 was the conventional par value of shares and this doubtless led to the above mentioned treatment of shares without par value. The tendency is to issue such shares for a consideration averaging approximately $20 and, if the use of shares without par value is to be encouraged, as it should be, they should be treated for the purpose of the bonus tax as if they were of the par value of $20. (Compare the Federal stamp tax on original issues, imposed by Section 1802 of the Internal Revenue Code, under which the tax on shares without par value is on each $20 of actual value, or fraction thereof, while the tax on shares having a par value is on each $100 of par value, or fraction thereof.)

It is also recommended that the exceptions be eliminated and that corporations without capital stock be required to pay the minimum bonus tax of $20. On an increase of authorized capital stock of a railroad incorporated under the laws of this State and one or more other States, the tax should be based upon such proportion of the authorized capital stock as the all track mileage of the railroad within this State bears to its all track mileage within and outside this State.

The present schedule has the merit of simplicity, but the second bracket ($150 for each $1,000,000 or part thereof) produces some unintended discriminations. For example, two corporations can be formed

and merge or consolidate, paying all bonus taxes and filing fees required, but still pay considerably less than it would cost to form one corporation in the first instance with the authorized capitalization of the surviving or consolidated corporation.

It is recommended that the schedule be revised to provide the following rates:

$1 for each $5,000, or part thereof, up to $1,000,000, but not less than $20.

Thereafter $10 for each $100,000, or part thereof, up to $2,000,000.

Thereafter $15 for each $500,000, or part thereof, up to $5,000,000.

Thereafter $20 for each $1,000,000, or part thereof.

The first and last brackets are the same as the first and last brackets of the present schedule with the fractions of a dollar eliminated. The second and third brackets replace, smooth out and lower somewhat the present second bracket.

In the fiscal year ended September 30, 1940, the bonus tax produced only $15,220. The subcommittee believes that the fair changes recommended above will tend to increase, not diminish, the present small revenue from this tax.

ANNUAL FRANCHISE TAXES

Domestic corporations

Under Section 136 every domestic "ordinary business corporation, excluding charitable, benevolent and fraternal institutions", is required to pay an annual franchise tax based on "the amount of its capital stock

issued, outstanding and/or subscribed for". Shares without par value are treated as if they were of the par value of $100 each.

The base prescribed permits substantial avoidance of the tax by the use of low par value stock. The amount by which the consideration exceeds the par value of the stock is credited to paid-in or capital surplus. Many corporations formed with shares having a conventional par value or without par value have changed their shares to shares having a low par value with concurrent credits to paid-in or capital surplus. A collateral disadvantage is the unnatural capital structures which result.

This tax avoidance can be prevented by changing the base to "issued capital stock plus paid-in or capital surplus by whatever name called". The new base can readily be determined by adding two figures on the income tax return, namely, items 15 and 16 on Schedule H, The tax should be calculated by the taxpayer on the return and added to and paid with its income tax. Any error therein made by the taxpayer would be picked up on audit of the return as in the case of other errors.

The franchise tax should apply to all domestic corporations, except corporations the shares of which are subject to ordinary taxes. The minimum tax of $10 should be continued. Corporations without capital stock would pay only this minimum. In the case of a railroad incorporated under the laws of this State and the laws of one or more other states, the tax should be imposed upon such proportion of the base as the all track mileage of the railroad within this State bears to its all track mileage within and outside this State.

The change recommended would result in a substantial increase in the base. The rate should therefore be adjusted downwards. At the same time the present unnecessarily complicated schedule should be simplified.

The subcommittee is deferring any recommendation of a specific schedule until a statistical study to be used in its preparation can be made. This will require spot checking of corporation income tax returns. It has not been thought advisable to ask the Income Tax Division to do this until more important statistics already requested by the Commission have been prepared.

Foreign corporations

Section 140 provides that "every foreign corporation, except insurance companies of all classes, charitable and benevolent institutions and corporations subject to a franchise tax measured by gross receipts, which does business or exercises its franchises or maintains an office in this State * * * shall pay an annual franchise tax upon the amount of capital employed by it in this State".

The phrase "capital employed * * * in this State" has been construed to mean gross assets in the State. (6 Op. A.G. 509). The tax therefore is in effect a property tax, differing in only three important respects from the ordinary property tax, viz: (a) it is inapplicable to corporations engaged exclusively in interstate or foreign commerce (17 Op. A. G. 382); (b) the base includes property exempt from ordinary taxes, particularly intangible personal property, and (c) the rate is regressive.

The tax thus discriminates in favor of corporations which are, or claim they are, engaged exclusively in interstate or foreign commerce. Furthermore the base includes intangible personal property but only such intangible personal property as has a situs in this State can be said to be "employed * * * in this State". Therefore the proper determination of the tax necessarily involves difficult and largely unsolved questions of business situs of intangible personal property. With the small amount

involved such assessment thereof as there is must necessarily be, and is, unchecked self-assessment.

All that can be said in favor of the present base is that in the past the reports have furnished to the State Tax Commission some kind of a check on local assessments of personal property of foreign corporations and that the tax has the stability which characterizes taxes imposed on a property base. Tangible personal property is now assessed by the State Tax Commission and intangible personal property formerly locally assessed is now exempt from property taxation so there is no longer anything to be said in favor of the present tax except that it has stability.

The franchise tax on foreign corporations assessed by the Commission for 1937, 1938 and 1939 was as follows:

	Number of corporations	Assessment
1937	1603	$ 106,118
1938	1695	113,181
1939	1413	107,339

It is obvious from these figures that approximately 40% of the revenue is derived from the $25 minimum tax. It appears from a partial check that a small amount indeed of the balance is attributable to the inclusion of intangible personal property in the base.

The subcommittee recommends that the franchise tax on foreign corporations, except for the $25 minimum tax, be abolished and that the revenue lost be raised by increasing the corporation income tax by one-half of 1%. To avoid discrimination against domestic corporations the franchise tax payable by them, except for the minimum tax of $10, would be allowed as a credit against the income tax and against the additional State property tax on railroads and utilities hereinafter recommended.

DOMESTIC UTILITIES - SHARE TAX

The "share" tax applies to national banks, domestic banks and trust companies, domestic "finance corporations" and domestic utilities. (Foreign "finance corporations" pay a tax on so much of their capital stock as represents the business done in this State.) Section 15(a) provides that the aggregate value of the shares must not be less than the total value of the real estate and tangible personal property in this State. As a practical matter this minimum provision only affects the assessment of shares of domestic utilities. In the case of domestic utilities it means, however, that the net taxable value of the shares (aggregate assessment less the real estate credit) is in substance an assessment of the tangible personal property for indirect taxation, since any intangible values, which in the case of a utility cannot be large, are more than offset by indebtedness.

The principal objection to this method of taxation in the case of utilities is that the assessment is allocated, not to the place in which the tangible personal property is located and protected, but to the counties and/or cities in which the stockholders reside. For the purpose of this allocation non-resident stockholders are treated as residing in the county and/or city in which the principal office of the corporation in this State is located. A similar defect in the method of taxing domestic ordinary business corporations was cured at the last session of the legislature.

Another objection is that assessment through the shares tends to obscure the minimum basis referred to above, particularly in the case of utilities with large indebtedness.

The net operating income allocable in Maryland of all domestic electric, gas and telephone utilities, excluding those having aggregate assessments of less than $25,000, was 9.0% in 1938 and 9.7% in 1939 of the aggregate assessments of their Maryland property for 1939. In other words, their operating properties earned 9.0% in 1938 and 9.7% in 1939 on these assessments - an average of 9.4%. This is more than sufficient, in the subcommittee's opinion, to show that direct assessments would not be less than the aggregate assessments of the shares under the present law if their property is valued in the manner recommended in the following section.

The subcommittee recommends that the tax on shares of domestic utilities be abolished and that their operating property, except land, be directly assessed by the central assessing authority. Their operating land and their non-operating property, if any, would be assessed in the same way that similar property of ordinary business corporations was assessed.*

CENTRAL ASSESSMENT - OPERATING PROPERTY

All real estate of all classes of railroads and utilities, domestic and foreign, and all tangible personal property other than rolling stock of railroads, domestic and foreign, and all tangible personal property of all foreign utilities, are locally assessed. Operating property of railroads and utilities consists principally of special classes of property which can only be assessed efficiently by experts.

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* Article 15 of the Declaration of Rights requires separate assessment of land. Operating land, but not improvements thereon, would continue to be locally assessed. The assessments of operating property other than land would be arrived at by deducting locally made assessments of operating land from valuations of all operating property made as described in the succeeding section.

Local tentative assessments of operating property range from less than 20% to more than 200% of the value of the property. When they are high they are contested; when they are low usually nothing is done about it. The result is that operating property of railroads, other than rolling stock, and operating property of foreign utilities is assessed at a lower percentage of value on the whole than the property of domestic utilities. (The share assessment picks up, to a considerable extent, under-assessments of real estate of domestic utilities.)

The weighted average percentages of net operating income (allocable to Maryland) for 1937, 1938 and 1939 in the case of railroads and 1938 and 1939 in the case of utilities, to the aggregate assessments* of their Maryland property for 1939 are illuminating.**

Railroads (locally assessed except for rolling stock)

1937	11.82%
1938	8.55%
1939	11.75%
Average	10.71%

(All railroads having a net operating income are included, except the Baltimore and Ohio and a very small railroad for which the property assessment is not available. The situation with respect to the Baltimore and Ohio is touched on below.)

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* As reported by the railroads.

** The same relation for a five year period for Class I railroads other than the Baltimore and Ohio is shown in following table:

1935	10.67%
1936	12.65%
1937	11.64%
1938	9.00%
1939	11.62%
Average	11.12%

Domestic utilities (centrally assessed through shares)

1938	9.0%
1939	9.7%
Average	9.4%

Foreign utilities (locally assessed)

1938	24.5%
1939	25.5%
Average	25.0%

(All telephone, electric and gas utilities having aggregate assessments of over $25,000 are included except one foreign utility for which no Maryland allocation fraction is available.)

The foregoing percentages for railroads and utilities were derived by the Commission's statistician by the use of the Maryland allocation fractions reported by the taxpayers on their 1938 income tax returns, except in the case of four small railroads which did not report such fractions. The allocation fractions reported on the 1939 returns do not vary sufficiently from those reported on the 1938 returns to change the results to any material extent. In the case of railroads which did not report allocation fractions, net operating income was allocated on a mileage basis.

The subcommittee recommends that all operating property, except land, of railroads and utilities be directly assessed by the central assessing authority. Their operating land and non-operating property, if any, would be assessed in the same way that similar property of ordinary business corporations was assessed.

There is a difference of opinion among tax experts as to whether rolling stock not owned by railroads or held by them under leases for a year or more should be assessed to the owners or to the railroads on which

it is used.* In Maryland such rolling stock is not assessed to anyone. In one way or another a State is entitled to tax its fair proportion of the rolling stock habitually operated over lines which pass into, through and out of the State, valued not merely as separate articles, but with reference to its use and what it earns. It is immaterial that the individual items of rolling stock are not continuously the same but are constantly changing. The law should specifically provide for such taxation, but, in the opinion of the subcommittee, practical administrative considerations should determine whether or not such rolling stock of any or all classes should be assessed to the owners or to the railroads. For that reason it is recommended that this matter be left to the central assessing authority.

Operating property of railroads and utilities, domestic and foreign, should be valued on the unit basis, making full use of capitalization of net operating income as a guide. In the case of a property lying partly in another State or other States a proper share of the unit valuation would be allocated to Maryland. The properties would thus be valued as going concerns and the valuations would include intangible values, but in the case of railroads and utilities, competition or regulation, or both, make intangible values small, and in some cases non-existent. The assessments of operating property other than land would be arrived at by deducting from the valuations thus made the locally made assessments of operating land.

The allocation of assessments of railroad and utility property among taxing districts in a State is more difficult than allocation between States, because statistics are not kept by taxing districts. Such

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* Round Table, "The Taxation of Car Lines", National Tax Association, Proc. 1938, 165; "Use v. Ownership as a Base for Taxation", ibid, 284, 291 and 318, 320; "The Assessment of Freight and Passenger Car-Line Companies in Illinois", Illinois Tax Com., 16th An. Rep. 148.

allocation is particularly difficult in Maryland with its large number of taxing districts, some of them overlapping. The best solution would be for the State to impose and collect all taxes on operating property of railroads and utilities and to adjust the matter as part of a largerplan for readjustment of State and local fiscal relationships.* Under the present complicated system some State collected taxes go into local treasuries while some locally collected taxes go into the State treasury. Such a readjustment would result in large administrative savings.

GROSS RECEIPTS TAX - RAILROADS AND UTILITIES

"A state tax as a franchise tax * * * measured by gross receipts" of "railroads worked by steam", and telegraph or cable, express or transportation, parlor car, sleeping car, telephone, electric, gas and oil pipe line companies, is imposed by Section 91. This tax applies to foreign as well as domestic corporations and nominally to partnerships and individuals. The measure of the tax is all receipts coming from business within the State. If a railroad has part of its road in this State and part in another State or States, it is to pay the tax "upon such proportion of its gross earnings as the length of its line in this State bears to the whole length of its line". Similar apportionments are provided to be made in the case of "each oil pipe line company, and each sleeping car, parlor car, express or transportation company, telephone or

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* For discussions of the problem and its solutions, see

"Intra-state Apportionment of Railway Valuations for Tax Purposes", National Tax Association, Proc. 1937, 269.

Round Table, "Grants-in-Aid and Sharing of State Administered Taxes; What to Share, How to Share, and How Much", Ibid, Proc. 1938, 336.

"Intergovernmental Fiscal Relationships", Ibid, Proc. 1939, 159.

telegraph or cable company". But after providing for statements on which to base such apportionments "so that the proportion of the said gross earnings of the said companies, respectively, accruing, coming from their business within this State, may be accurately ascertained", Section 91 provides that the "statement may be made in any other mode satisfactory to and required by the State Tax Commission". The report is to show "total receipts accruing from business done in this State". (Section 92.) The law thus taxes, or purports to tax, interstate and foreign as well as intrastate receipts. (Cumberland & Pennsylvania R. R. Co. v. State, 92 Md. 668.)

The tax is in conflict with the commerce clause of the United States Constitution in many of its applications. The result is that in some cases it is not imposed at all; in others under various compromises, and only in a few as written. It should be repealed and the revenue raised by a tax which can be applied equally.

The subcommittee recommends an additional State property tax, applicable to operating property, except land. Land is excepted because Article 15 of the Declaration of Rights provides that State, County and Baltimore City taxes shall be uniform as to land within each taxing district.

Such classification for additional State property taxation is permissible under Article 15 of the Declaration of Rights. There is clearly no objection to it under any provision of the Federal constitution. (Nashville, C. & St. L. Ry. v. Browning, decided by the Supreme Court on May 20, 1940.)

The tax should, in addition to replacing the gross receipts tax, replace the income tax on income from operating property, but "other income",

less related expenses, would remain subject thereto.

In the opinion of the subcommittee the new tax should be payable, not only by the railroads and utilities to which the present gross receipts tax in terms applies, but by their competitors.

Domestic railroads are subject to local property taxes, but are not subject to the State property tax. (Section 7(16).) Foreign railroads and all utilities are subject under the law to State as well as local property taxes. In practice, however, the exemption from the State property tax is accorded to all railroads. With the repeal of the gross receipts tax this exemption should be repealed.

The new tax would be levied at a rate or rates sufficient to offset the loss of revenue from the gross receipts tax and the income tax in so far as the new tax replaces it, less (a) the revenue from extending the State property tax to railroads, (b) the increased revenue which will accrue to the State from unit assessments of property of railroads and utilities, and (c) the revenue from the income tax which will become payable on dividends on shares of domestic utilities on the abolition of the tax on their shares.

GROSS RECEIPTS TAX-SAFE DEPOSIT, TRUST AND TITLE INSURANCE COMPANIES

Section 91(a)(2) imposes upon safe deposit and trust companies a gross receipts tax at the rate of 2-1/2%, "with respect to their safe deposit and trust business, including all receipts derived from the business of acting [in a] fiduciary or representative capacity", and at the rate of 2% "on all receipts derived from the business of insurance or guaranty (if any)". National banks, and, to a limited extent, State banks,

compete with trust companies for safe deposit and trust business, but the tax in its present form is inapplicable to them. The necessary result is discrimination, which is largely against domestic safe deposit and trust companies in favor of national banks.

To remove such discrimination it is recommended that the 2-1/2% tax be imposed upon the customer to whom the service is rendered, but that the company rendering the service be made responsible for payment.* This obligation may be imposed upon national banks. (Colorado National Bank of Denver v. Bedford, decided by the Supreme Court on April 22, 1940.)

Section 91(a)(3) imposes upon title insurance companies a gross receipts tax of 2% "with respect only to their receipts derived from the business of insurance and guaranty". The tax imposed by Section 91 (a)(2) upon safe deposit and trust companies at the rate of 2% "on all receipts derived from the business of insurance or guaranty (if any)", complements the tax imposed on title insurance companies by Section 91(a)(3). It is recommended that the foregoing provisions be repealed and that Section 39 of Article 48A be amended so as to subject the business aforesaid to the 2% tax on premiums imposed in the case of "other writings".

Section 91(c) is as follows:

> Every partnership or individual engaged in any of the above enumerated branches of business in this State shall be subject to the tax imposed by this section and comply with all provisions relating thereto as if such firm or individual were a corporation.

Although many individuals are acting in a fiduciary capacity, no individual or partnership pays any gross receipts tax. (Apparently no individual or partnership is in any other business subject to the gross receipts tax.) The law imposing the tax on partnerships and individuals should be either enforced or repealed. The subcommittee believes that it

* The 1928 Report, page xxxii, recommended that the tax be repealed.

would be difficult to enforce it and accordingly recommends that it be repealed. Such repeal would not of course result in any loss of revenue.

VESSEL PROPERTY

A State has power, if it wishes to exercise it, to tax all vessel property owned by its residents, including domestic corporations, when it does not appear that the vessels have an actual situs elsewhere. Thus it has power to tax ocean going vessels owned by a domestic corporation whether or not they are ever within its borders. (Southern Pacific Co. v. Kentucky, 222 U. S. 63.) Maryland has long exercised this power. (Section 6 (9).) A State cannot, however, tax such vessels when owned by a foreign corporation. The diminishing number of ocean going vessles owned by domestic corporations are all accorded the exemption granted by Section 7 (28). Accordingly no State or local taxes accrue from them. The present policy results in no advantage to the State, but on the contrary in a disadvantage in that it effectively prevents domestic corporations from owning ocean going vessles other than such as are within the limited exemption. It thus discriminates against domestic corporations in favor of foreign corporations, forcing even Maryland residents to incorporate elsewhere if the corporation is to own vessel property not within the limited exemption. Furthermore the exemption furnishes no inducement to local incorporations, but the contrary. It is limited not only in scope but in duration. The foregoing is equally applicable to air-craft.

The subcommittee recommends that Section 6 (9) be repealed and that such other changes in the law be made as may be necessary to remove the threat of property taxation of vessels and air-craft other than those which have an actual situs in the State.

INCOME FROM DIVIDENDS AND INTEREST

The tax on net income from dividends and interest received by corporations applies only to dividends and interest on intangible property having a "business or commercial situs either in this State or outside this State". The portion thereof derived from or reasonably attributable to the trade or business in this State is allocated to this State. (Section 246(b).) By so limiting the tax it was possible to make it apply equally to domestic and foreign corporations, thus avoiding discrimination against our own corporations.

Any allocation of income from dividends and interest presents a difficult problem. Distinguished committees of the National Tax Association have been studying the matter for over twenty years and what was intended as a final report on allocation was made at the thirty-second conference on October 17, 1939. (Proc. 1939, 190.) A prepared comment on the report read at the conference deals with the matter as follows:

> The committee's * * * recommendation that if income from interest [and] dividends * * * is received in connection with business carried on within a State, such income should be allocated to that State, is vague and indefinite. Under what circumstances would such income be considered received in connection with business? The report gives no answer to this question.
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> At the present it appears likely that income of corporations from intangibles may constitutionally be taxed by any or all of the following states:
>
> 1. The State of incorporation of the owner;
> 2. The State where the principal office or commercial domicile is located;
> 3. The State where the intangibles have acquired a business situs; and
> 4. The State of the payer's residence or domicile.
>
> In view of this definite possibility of multiple taxation, together with the great confusion which exists concerning the taxation of intangible income, it is earnestly recommended that this subject be given further consideration. (Proc. 1939, 222.)

The subcommittee agrees that the problem has not been satisfactorily solved, and doubts whether it can be solved in a way that eliminates multiple taxation or the threat thereof. The subcommittee recommends that this item of net income to corporations be eliminated. (A similar problem is presented in the case of non-resident individuals. It is suggested that it be dealt with in the same way.)

The subcommittee believes the revenue involved will prove to be small. An estimate thereof based upon a spot check of returns should be requested as soon as the Income Tax Division has completed the more important data which it is compiling for the Commission.

DISCRIMINATIONS AGAINST ORDINARY BUSINESS CORPORATIONS

In Leser v. Lowenstein, 129 Md. 244, 260, the Court of Appeals said that "the main object of the creation of the commission was to secure the equalization of assessments". All taxable property was to be "equalized between persons, firms and corporations, so that all persons, firms and corporations shall be assessed alike for like kinds of property" (Section 166 (4)). Thus there was to be no distinction in the treatment of like property of persons, firms and corporations. But it must be admitted that the purpose of the law has not been accomplished to any great extent. For example, tangible personal property of ordinary business corporations which is centrally assessed, annually on sworn returns, is assessed at approximately 100% of its value, while like property of persons and firms which is locally assessed, usually at long intervals and usually not on returns of any kind, is generally assessed at much less than its value. The subcommittee hopes that this discrimination against ordinary business corporations will be eliminated by improved administration under the amended law.

There is justification for a higher tax on earnings derived through corporations than on earnings not so derived, but the difference under the Maryland income tax law, i.e. a maximum difference of 5%, is too great. Further consideration will be given to this matter as soon as an analysis of 1939 income tax returns has been received from the Comptroller.

SECTION 3 (c)

The subcommittee recommends that Section 3 (c) be amended as follows:

By inserting after the word "but" in the third line, "except as hereinafter provided,".

By striking out the clause beginning ",with such right of indemnity".

By adding the following:

Unless otherwise provided by regulations of the central assessing authority, the consignee shall be chargeable with the taxes on consigned property of every class.

Unless otherwise provided by regulations of the central assessing authority, a railroad or utility which occupies or uses property of any class of another person shall be chargeable with the taxes on such property.

Unless otherwise provided by regulations of the central assessing authority, a railroad on which rolling stock of another person is used shall be chargeable with the taxes on such rolling stock.

When a person is chargeable with the taxes on property owned by another person such property shall be assessed to the person chargeable with the taxes thereon as if he were the owner.

Although a person other than the owner of property may be chargeable with the taxes thereon, collectors may, if the property is separately assessed, collect such taxes from the owner.

A person paying taxes on property of another person shall have a lien thereon for such taxes and such right to indemnity from other persons as may be provided by private contract, express or implied, in fact or in law.

SECTION 5219

The subcommittee does not believe that much improvement can be made in the method of taxing banks, trust companies and other corporations substantially competing with national banks until Section 5219 of the Revised Statutes of the United States (12 U.S.C. Sec. 548) is further amended. A State should be permitted to impose on national banks exactly the same burden of taxation that it imposes on State banks, trust companies and other corporations substantially competing with national banks, but no greater burden. The subcommittee hopes that Section 5219 will be amended so as to permit such taxation of national banks.

Section 5219 permits taxation of real estate as well as shares of national banks. It does not in terms require deductions from the value of the shares of either the assessed value of real estate or the assessed value of shares in other national banks such as are allowed in Maryland. These deductions were originally provided for on the theory that otherwise there would be a double tax prohibited by the Declaration of Rights. This, however, is no longer the law. (Fidelity and Guaranty Fire Corporation v. Leser, 172 Md. 652, in which the Court of Appeals sanctioned the elimination of the deduction of the assessed value of shares in domestic corporations.)

The Supreme Court has held that under Section 5219 shares in a national bank owned by another national bank may be taxed, as in Maryland, but, if taxed, the full taxable value of such shares must be deducted in determining the taxable value of the shares of the national bank which owns the shares, as in Maryland. Shares in other corporations owned by national banks may not be taxed to such national banks, but shares in other corporations owned by corporations other than national banks may be

taxed to such other corporations, as in Maryland, without any deduction for their taxable value, as in Maryland. Compliance with Section 5219 and the decisions of the Supreme Court does not require this discrimination against shares in other corporations. The subcommittee recommends that it be eliminated by changing the exemption in Section 7(15) from "tangible personal property" to "personal property" and striking from Section 15(b) the provision for deduction of the taxable value of shares in national banks. (Such deduction is only required when the State exercises its right under Section 5219 to tax to one national bank shares owned by it in another national bank.)

While the entire real estate deduction could be eliminated the subcommittee believes that a fairer plan would be to limit the deduction to the proportion of the real estate assessment that capital, surplus and undivided profits bear to capital, surplus, undivided profits and indebtedness.

LIMITATIONS

Under Sections 143 and 151 as enacted by Chapter 226 of the Laws of 1929, State as well as local taxes, for which no other period was prescribed, were required to be collected as well as assessed, within four years after their due date. Chapter 88 of the Laws of 1933, Special Session, repealed this limitation as to State taxes. Section 31 makes escaped property "subject to taxation for current and previous years, not exceeding four years in all". This section was not disturbed. Under Section 240, if the amount of the income tax computed by the Comptroller is greater than the amount returned by the taxpayer, the excess must be assessed "within three years from the date the return was originally due

or filed, except in the case of failure to file a return or of a fraudulent or incomplete return". Thus, in general, as the law stands today, there is a four year limitation upon the assessment of State and local property taxes; a three year limitation upon the assessment of income taxes; no limitation upon the assessment of other State taxes; a four year limitation upon the assessment of other local taxes; no limitation upon the collection of any State taxes, and a four year limitation upon the collection of all local taxes.

The subcommittee sees no justification for the distinctions between State and local taxes, except as to the income tax, and, to remove them, recommends the repeal of Chapter 88 of the Laws of 1933, Special Session.*

The subcommittee suggests that the limitation provisions of the Income Tax Law be brought into closer accord with those of Sections 275, 276 and 277 of the Internal Revenue Code. In any event it is suggested that the words "or incomplete" in Section 240 be eliminated.

Similar limitations should be placed upon the right to refunds.

BALTIMORE AND OHIO RAILROAD COMPANY

Chapter 155 of the Laws of 1878 (known as the Settlement Act) provides "that all the franchises and property of every description and

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* The 1928 Report forcefully said (at page xv): "The present general law prescribes no period of limitations for State taxes, although the lien of certain State taxes expires after the lapse of specified times. Statutes of limitations rest upon demonstrated principles of public policy favoring peace and any existing status, and discouraging stale claims. There is no reason why the State should be exempt from principles of justice and public policy which it prescribes for others. On the contrary, there is every reason why, being itself 'the fountain of justice', it should also be the model of justice. We have accordingly provided that all taxes without exception must be collected within four years from the time they fall due, except of course in cases of fraud."

gross receipts of the Baltimore and Ohio Rail Road Company within the State of Maryland, shall be subject to taxation for State purposes to the extent of an annual tax of one half of one per centum on the gross receipts of its rail roads and branches within this State, including its Metropolitan Branch Rail Road, and from its entire Washington Branch Rail Road, and from all other sources within this State, but to no further or greater extent, nor otherwise; And * * * no other, further or greater tax or burden for State purposes shall ever hereafter be levied or imposed by the authority of this State, or by any law thereof, upon any of the franchises or property of any description or receipts whatsoever of said company; Provided, that nothing in this act shall be construed as exempting any property or franchises of the said rail road company from taxation for county and municipal purposes, which by existing laws and the decisions of the court of appeals of this State, is now held liable to taxation".

Under the decisions of the Court of Appeals Section 18 of Chapter 123 of the Laws of 1826 (the original charter of the Company) exempted from taxation the road from Baltimore to the Ohio River and the lateral roads constructed under the authority of that act, and all buildings and works (and other property) necessary and expedient to the operation of the road (and such lateral roads), and also the receipts therefrom, but not (a) the Metropolitan Branch or the Washington Branch or the receipts therefrom, or (b) any other property or receipts of the Company. The Metropolitan and Washington Branches were constructed under acts which contained no tax exemption. (Mayor and City Council of Baltimore v. The Baltimore and Ohio Rail Road Company, 6 Gill 288, State v. The Baltimore and Ohio Rail Road Company, 48 Md. 71, 76.)

The intangible personal property of the Company was assessed at $64,689,000 for 1938 taxation and at $36,902,040 for 1939 taxation. It is understood that the decrease was due mainly to the drop in market prices. The local property tax thereon (thirty cents on each $100 of valuation), theretofore paid by the Company, was repealed by Chapter 277 of the Laws of 1939, which concurrently imposed a higher income tax. The Company contends, however, that under the Settlement Act this tax is not payable by it. When the Settlement Act was passed the full local rate was applicable to intangible personal property.*

The subcommittee recommends the enactment of a provision to the following effect applicable to all corporations which claim contract exemptions:

> Whenever any corporation shall claim that it is entitled under a contract with this State to an exemption from ordinary or special taxes imposed by this Article or by any other Article of the Code of Public General Laws, (a) all real property and tangible personal property located in this State, owned by such corporation and not subject to ordinary taxes under any other provision of this Article, shall be subject to assessment to such corporation and taxation for ordinary State and county and/or city taxes in the county and/or city in which such property is located, except taxes thereon from which such corporation is entitled to exemption under such contract, and (b) all interests, shares and proportions, owned by such corporation and not subject to ordinary taxes under any other provision of this Article, in all ships or other vessels which have not an actual situs for taxation outside of this State, whether such ships or other vessels are in or out of port, all bonds,

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* The following are the only classes of intangible personal property which were exempt from taxation at the time of the passage of the Settlement Act:

> Shares in * * * a National Bank not located in this State * * *
>
> Bonds made by any State exempted from taxation by the law of the State authorizing the issue of such bonds * * *
>
> Mortgages upon property wholly within this State, and the mortgage debts secured thereon * * *
>
> Bonds, stock, or evidences of debt issued by the United States. (Revised Code, 1878, Article 11, Sections 2, 3.)

certificates of indebtedness or evidences of debt, owned by such corporation and not subject to ordinary taxes under any other provision of this Article, in whatsoever form made or issued by any public or private corporation or made or issued by any State, territory, district, possession or foreign country, all mortgages, owned by such corporation and not subject to ordinary taxes under any other provision of this Article, and all shares of stock or shares, owned by such corporation and not subject to ordinary taxes under any other provision of this Article, in any corporation, shall be subject to assessment to such corporation and taxation for ordinary State and county and/or city taxes in the county and/or city in which the principal office of such corporation in this State shall be located, except taxes thereon from which such corporation is entitled to exemption under such contract, unless prior to January 1, 1942, such corporation shall have delivered to the Secretary of State of this State a duly authorized instrument in writing electing to abandon its right to all exemptions from ordinary and special taxes to which it claims to be entitled under any such contract.

Although as noted above all intangible personal property, except the several classes thereof then exempt from taxation, was subject to full rate taxation at the time of the passage of the Settlement Act, the subcommittee recommends that intangible personal property taxable under the above proposal, but not otherwise taxable, shall be subject to taxation for county and municipal purposes at the rate of thirty cents on each $100 of valuation.

It is suggested that the intangible personal property of the Company be taxed for 1940 and 1941 by a retroactive provision, since the effect of Chapter 277 of the Laws of 1939 was to relieve the Company from any tax thereon for 1940 and subsequent years.

The Settlement Act imposes an annual tax of one-half of one per cent on the gross receipts of the Company's 'rail roads and branches within this State, including its Metropolitan Branch Rail Road, and from its entire Washington Branch Rail Road, and from all other sources within this State'. This tax applies to the Maryland portion of receipts from interstate commerce as well as to Maryland intrastate receipts. It also

applies to the receipts from the 'entire Washington Branch Rail Road', which is partly in the District of Columbia. No method of apportionment is prescribed or indicated by the Settlement Act. The Company apportions its operating revenues, intrastate as well as interstate, on a road mileage basis, following the plan prescribed by Section 91 when no other mode of apportionment is required by the State Tax Commission. This method may have produced reasonably fair results when it was first adopted, but under present day conditions it is universally regarded as too crude for use except in the simplest situations. All track mileage would produce more accurate results with no increase in the burden of computation. But there is no sufficient reason for not using the standard method of allocating operating revenues, namely:

1. Allocate Maryland intrastate operating revenues to Maryland,

2. Allocate to Maryland its mileage prorate of interstate operating revenues.

(Receipts from the entire Washington Branch would be treated as if they were intrastate receipts),

According to a distinguished spokesman for the railroads, William T. Faricy, General Solicitor, Chicago & Northwestern Railway Company, this method "is simple, actual (i.e., it rests upon an actual base), and the data for its determination are readily available". National Tax Association, <u>Proc.</u> 1937, 251, 253.

This tax should be administered by the central assessing authority.

MISCELLANEOUS

A person who transacts business in the name of a corporation the charter of which has been forfeited should be subject to a fine, if he knew at the time that the charter had been forfeited. A person who was an officer or director at the time of forfeiture should be presumed to know of the forfeiture.

A person who transacts business in the name of a corporation when no good faith attempt has been made to incorporate such a corporation should likewise be subject to a fine.

A person who transacts the business of a corporation in a name or way designed to indicate that the business is that of an individual or a partnership should be chargeable with the liabilities thereof and should also be subject to a fine.